

TIME WARNER

Arthur B. Sackler, Esq.
Vice President-Law
and Public Policy

April 15, 1998

The Honorable John McHugh
Chairman
Subcommittee on the Postal Service
Committee on Government Reform and Oversight
United States House of Representatives
Washington, DC 205 15

Dear Mr. Chairman:

RE: Comments of Time Warner on the Revision of HR 22

Time Warner is very pleased to have the opportunity to comment upon your revised version of HR 22, the Postal Reform Act of 1997. We are particularly appreciative that you have accepted our request to file them past the time limit you set.

The U.S. Postal Service is at a crossroads in its life cycle, Time Warner believes. While the Postal Reorganization Act and the system it governs have served the American public well since their inception in 1970, we now live in a significantly different environment characterized by new business challenges, such as strong competitors in conventional distribution, e.g., Federal Express. And, of course, the drafters of the PRA in 1970 could not have envisioned perhaps the most pervasive and efficient means of communications and distribution yet devised: the Internet. It now has some 100 million users worldwide, more than doubling annually, and is a large and growing force in the market through what is becoming known as "ecommerce." A more fundamental competitive threat to the Postal Service has never existed.

At the same time, the Postal Service has performed admirably in recent years. Buoyed by a strong economy, it has shown profits well in excess of \$1 billion in each of the past three years. It is, as of this writing, well on its way to a fourth such year. However, there are danger signs on the horizon. First class mail growth has slowed as consumers become more comfortable with electronic banking and bill payment. Labor continues to represent 80% of Postal Service costs, in spite of billions of dollars in capital expenditures. Competition for the delivery of messages and products to businesses and consumers, both online and conventionally, continues to escalate. So, while the Postal Service appears to be on solid fiscal ground today, a crisis very well may loom in the not-too-distant future.

As a result, postal reform legislation is a necessity. However, it is critical that any new legislation be created with the goals of protecting this vital institution and allowing it

to thrive in a more competitive world. A number of the revisions that were issued on December 10, 1997, represent significant alterations from HR 22 as introduced that likely would be counterproductive to increasing Postal Service competitiveness. The comments that follow will outline our concerns and suggestions for constructive change to specific provisions of the revised draft.

Baseline Rates

While certainly not ideal, the ratesetting system in the PRA, in our view, generally facilitates the creation of reasonably fair and equitable rates. We believe that, in all likelihood, that will continue to be so. Therefore, whatever rates are in effect when legislation is enacted can and should serve as the baseline for future adjustments by indexation or otherwise. If a new baseline case were required it would result in unnecessary and extensive litigation for both the Postal Service and the mailing community. In fact, mailers commonly refer to such an event as “the Mother of all rate cases.”

Such a case would have so much at stake that it surely would result in intense intra-class as well as inter-class disputes. This would make it incumbent upon any responsible mailer to mount major offensive and defensive litigation strategies, with all the costs in time, effort and treasure that would entail. We believe that new baseline rates simply are unnecessary and would end up benefiting Postal Service competitors more than customers through the manifest means of providing additional room for their increasing prices while still being able to undercut artificially raised USPS prices.

International Mail

As recently as last week, our publishing subsidiary Time Inc. was called upon by the Royal Mail (Great Britain) which was seeking to win our ISAL (International Surface Air Lift) business from the Postal Service. In this meeting, the rates provided clearly under bid the Service’s present rate card. If we allow the new legislation to further saddle the Service’s competitiveness, its base business will slowly be “cherry picked” and USPS will only service areas that are unprofitable for its competitors. Therefore, in the international arena, HR 22 should remove all restraints (as other foreign postal services have done) and allow the Postal Service to compete aggressively, as long as it meets the standards of covering incremental costs and making some contribution to overhead. This contribution does not necessarily have to equal the contribution made by other baskets of mail, which is the same logic that business applies in pricing various competitive products. The bottom line is if international mail can provide a contribution to overhead, then USPS should have freedom to compete. Without such freedom, it will be priced out of the market and, make no mistake about it, competitors will secure the business. The American public would be better served by having a positive revenue stream from international mail rather than no revenue stream.

Time Warner also believes that USPS should be permitted to continue representing the United States at the Universal Postal Union. In its non-competitive

products, which still represent the great bulk of its business, USPS continues to provide an essentially and traditionally governmental service to the American public. Much of the focus of the UPU is on such non-competitive products and how they will be handled in price and in operations across borders. USPS remains uniquely situated and knowledgeable within the US Government to participate and negotiate in this forum. And this is in full recognition of the amply experienced and talented negotiators at the US Trade Representative's Office. Moreover, this is consistent with the approach of other nations. In our view, until USPS becomes preponderantly a distributor of competitive products, it should remain the US delegate to the UPU.

Price Index

Time Warner has long been supportive of price caps or indexation as incentives for the tough fiscal discipline and aggressive marketing that any business needs to succeed in a very competitive marketplace. CPI, while offering the potential for some brake on pricing, only would encourage the Postal Service to match the general economy, however well or badly it might be doing at a given point in time. The GDPPI, which was included in the original draft, would set a target of outperforming the economy, especially if accompanied by a reduction for productivity gains. This reduction, we anticipate, would reflect improvements, among others, resulting from the billions of dollars spent on automation. The price index and productivity adjustment factor should be the same for all non-competitive baskets. The performance goal should not be ordinary, but superior; not the economy as a whole, but better. An index such as the GDPPI would get us there.

It is also worth noting that, despite reductions in the measurement of CPI in each of the last four years, it is not at all clear that critics of its overstatement of inflation, such as Federal Reserve Board Chairman Alan Greenspan, have been assuaged. The overstatement, if still accurate, would imply a performance incentive that would not even reach to the level that the economy in general is obtaining.

The banking of unused pricing changes appears to us quite problematic. It would defeat the purpose of having a price cap by raising the specter of balloon payments in future years. The banking provision would allow that to happen, even in the face of the two percent banding requirement. To illustrate, a business might prepare a five-year plan that assumes a two percent increase each year. When USPS has banked unused price increases, it could impose increases as much as double what was called for in that five-year plan. This would be crippling to an essential need of business: long-term planning. These kinds of severe variations are exactly what mailers are attempting to avoid in the new legislation. We urge you to delete the banking provision.

Competitive Products

Time Warner believes that this basket provides the greatest opportunity for growth, but only if a sufficient degree of freedom is afforded to the Postal Service to

enable it to compete effectively. To so enable it, HR 22 should require that competitive products cover their incremental costs and make some contribution to overhead. Such a contribution should not be mandated to be equal to the non-competitive baskets. This should provide USPS pricing flexibility on its most competitive products, yet ensure that no cross-subsidies take place. If the attributable costs are being covered, and some reasonable contribution to overhead is being made, volume increases will result in an improved bottom line. On the other hand, if the constraints on competitive product pricing are too tight, little will change and USPS will have been deprived of perhaps its major method to offset diminishing volume from electronic and other competition at some point in the not-too-distant future.

Negotiated Service Agreements

Time Warner negotiates service agreements with postal administrations throughout the world, with the notable exception of the United States. Such service agreements result in win/win situations for both the postal administration and our company. In exchange for pricing incentives, we provide volume commitments that grow over the term of the agreement. In many cases, we also undertake worksharing initiatives that help to reduce costs. These agreements permit mailers, including us, to develop partnerships with local postal administrations. Such partnerships are built upon the concept of providing incentives for the portions of the business that the postal administration wants to grow and locking in volume that could possibly migrate to competitors. In fact, there have been occasions--and fortunately, very few!--where we have not met our contractual volume targets. In those cases, financial penalties were incurred. These partnerships would help guarantee a successful U.S. Postal Service in the future.

Obviously, negotiated service agreements (NSAs) are the key to such partnerships here in the U.S. But it must be emphasized that they should be based upon either volume growth or worksharing. Neither alone as the basis for NSAs will attract enough participants to truly realize the benefits from this market-based approach.

In addition, NSAs must be allowed to include all baskets of products, since each of our various products tends to drive volume in our other product lines. For example, in our experience, one magazine subscription to TIME Magazine generates some 90 pieces of mail including First Class, Periodicals, Standard A, and Standard B.

Finally, NSAs must be equitable to other mailers, including those who do not have agreements. They should be available on substantially equal terms to all comers similarly situated. All NSAs also should meet the test of covering their incremental costs plus making some contribution to overhead.

Market Tests

As in any business, new products are critical to future success. However, new product tests should not be limited by funding insufficient to permit a test broad enough on a geographic, volume or other relevant basis to return adequate data on which the Postal Service could make truly informed judgments. We also would be concerned about an approval process which would allow competitors time to create similar products that beat the Postal Service to market. Therefore, we recommend that market tests of up to \$100 million and for up to two years, at the discretion of the Board of Governors, be permitted. At the end of the test period, these products should then be classified in the appropriate basket and priced through a PRC proceeding.

Nonpostal Products

Time Warner generally supports permitting the Postal Service to engage in providing products outside its traditional sphere of expertise. The potential revenue benefit from an extension into new businesses is substantial, but so is the risk to the Service's customers and competitors. Therefore, this can only occur with appropriate safeguards which we believe that the private law corporation, drawn from successful examples, such as Conrail and Comsat, would provide.

Equal Application of Laws and Universal Service

Leveling the playing field between the Postal Service and its competitors is a generally desirable goal for competitive products. A key to doing so is the evenhanded application of conventional law to all players. Antitrust, trademark and the other legal areas set out in your revision should be applied, and blindly, to every competitor, including USPS. But they should only apply where there is competition.

Noncompetitive products should remain unaffected by this change. To apply these rules prematurely, i.e., before competition actually develops, would risk substantially burdening prices and perhaps operations to the distinct detriment of the Service and its customers.

Universal service, in our view, remains essential. Not only does it continue to serve the high-minded and still quite relevant purpose of "binding the nation together," but it is a modern-day necessity for national mailers and marketers. It is also a further reason why conventional law should not be applied prematurely to noncompetitive products. Serving every citizen everywhere in our huge and complicated country is at the heart of the compact the Congress has long since made with the public about its postal system. Giving the Postal Service wide latitude to accomplish this ambitious and admirable goal forms an essential quid pro quo for universal service. Premature application of non-postal laws would be at odds with that exchange and potentially raise real questions concerning the efficacy of providing that service to each such product and its mailers.

Compensation Reform

The USPS compensation system should receive serious attention for reform and modernization. Even though its bottom line has been healthy with the current system, the results would be even better and more consistent over time by applying the right incentives. Performance-based pay should be routinely incorporated in the compensation of employees at every level, from the newest entrant to the Postmaster General. Whether as part of a collective bargaining agreement, or the bonuses of mid- or upper-level managers, or otherwise, incentives for continually improving performance should be included.

Overall, we applaud the efforts of the Subcommittee. By incorporating the revisions suggested in this response, we believe that you and your colleagues would lay the basis for meaningful postal reform legislation that Time Warner could thoroughly support.

Thank you again for considering our points of view.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Sackler", written in a cursive style.

Arthur B. Sackler